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Saratoga Fishing Co. v. J.M. Martinac & Co.: Charting the Course of "Other Property" in Products Liability Law

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Saratoga Fishing Co. v. J.M. Martinac & Co.: Charting the Course of "Other Property" in Products Liability Law*

I. THE BOW: INTRODUCTION

The M/V SARATOGA sank due to a hydraulic system fire on board the vessel. As a result, the vessel's owner lost the entire vessel, including equipment that the previous owner, his seller, had installed on the vessel to enable the vessel to fish for tuna. Presumably, the owner did not bring a warranty suit against the previous owner because he bought the vessel "as is" from the previous owner and the previous owner was probably insolvent.[1] Therefore, the owner sued the vessel's manufacturer and the hydraulic system's designer in federal court under strict products liability, alleging that the manufacturer defectively designed the hydraulic system.[2]

After trial, the district court concluded that the manufacturer and designer had defectively designed the hydraulic system and allowed the owner to recover under strict products liability for the tuna-fishing equipment added by the previous owner. The Ninth Circuit, applying products liability law as recognized in maritime law by *East River Steamship Corp. v. Transamerica Deleval, Inc.*,[3] reversed, holding that the equipment added by the previous owner is part of the "product itself," and is therefore economic loss, not recoverable under products liability.[4] The United States Supreme Court, granted *certiorari* to "resolve the uncertainty about *East River*" and reversed.[5] *Held*: For purposes of strict products liability, the "product itself" is the item that the initial user bought and everything else that is added or connected to this item is "other property."[6]

Often, as in *Saratoga Fishing Co.*, a dissatisfied purchaser has the possibility of a contract claim as well as the likelihood of a tort claim when a product is defective. Products liability law lies at the boundary between tort law and contract law.[7] There are several reasons why the injured plaintiff may not be able to or not want to recover under a contract theory and will prefer to recover under a tort theory. As in *Saratoga Fishing Co.*, the contract may limit the damages available for a defective product, e.g. buying a product "as is". The

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1. Saratoga Fishing Co. v. Marco Seattle, Inc., 69 F.3d 1432, 1444 (9th Cir. 1995).
2. *Id.*
3. East River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 106 S. Ct. 2295 (1986).
4. *Id.*
5. Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1785 (1997).
6. *Id.* at 1788-89.
7. Thomas C. Galligan, Jr., *Contortions Along the Boundary Between Contracts and Torts*, 69 Tul. L. Rev. 457, 459-62 (1994).

contracting party may be insolvent. Prescription, or the statute of limitations, for warranty actions may have expired. There may be no contract between the injured person and the manufacturer. Lastly, punitive damages are not available in warranty actions.[8] Courts and defendants have increasingly used the economic loss doctrine to limit the recovery available under products liability.[9] "The economic loss doctrine limits the recovery of damages in tort for product defects when the defect has caused neither personal injury nor damages to property other than the manufacture's [product] itself."[10] Basically, if the product causes damage to itself this damage is purely economic loss and the plaintiff cannot recover under a tort theory. He must recover under a contract theory. But if the product causes damage to a person or other property the damage is a type of economic loss that is recoverable under tort law.

The Supreme Court, in *East River Steamship Corp. v. Transamerica Deleval, Inc.*, adopted the common law of products liability into general maritime law.[11] By making this decision, the Supreme Court incorporated the economic loss doctrine into the general maritime law.[12] Consequently, the Court decided that tort recovery should not be available for damage that a product causes to itself, since that is purely economic loss.[13] Damage that the product causes to itself is "economic loss" and "is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain."[14] But, the Court said a tort remedy is available for damage to "other property."[15] However, *East River* provided little or no guidance on how to distinguish between damage to the "product itself" and damage to "other property."[16]

The Supreme Court, in *Saratoga Fishing Co. v. J.M. Martinac & Co.*, discussed how courts should draw the distinction between the "product itself" and "other property."[17] In *Saratoga Fishing Co.* the Court held that the "product itself," for purposes of applying the economic loss doctrine, is the item that the initial user purchases from his seller. Everything else that is added or connected to that item subsequent to this purchase is "other property." So, the initial seller or manufacturer is liable in tort to the subsequent user for all component parts added by the initial user.

This article focuses on the *Saratoga Fishing Co.* decision. Part II traces the economic loss doctrine from its beginnings to the present. Part III discusses the Supreme Court's adoption of products liability law and the economic loss

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8. Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. Rev. 891, 898 (1989).
9. *Id.*
10. *Id.* at 892.
11. East River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 106 S. Ct. 2295 (1986).
12. *Id.* at 863-71, 106 S. Ct. at 2300-02.
13. *Id.* at 870, 106 S. Ct. at 2302.
14. *Id.* at 868, 106 S. Ct. at 2300.
15. *Id.* at 867, 106 S. Ct. at 2300.
16. *Id.*
17. Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1783 (1997).

doctrine into general maritime law. Part IV concentrates on the Court's decision in *Saratoga Fishing Co.* Part V evaluates and discusses the decision in *Saratoga Fishing Co.* Part VI discusses the impact of *East River* and predicts the impact of *Saratoga Fishing Co.* on product liability cases outside of maritime law.

II. THE COURSE: TORT LAW AND THE "ECONOMIC LOSS" DOCTRINE

The economic loss doctrine has its origin in the nineteenth century.[18] In the 1842 case of *Winterbottom v. Wright*, a coach driver was injured when the axle on the coach that he was driving broke. The coach's repairer had just repaired the axle. The driver brought suit against the repairer for his injuries. The Exchequer held that the coach driver was not entitled to recover for breach of contract or for damages under tort law from the repairer of the coach for personal injuries sustained by the driver.[19] The driver was not in privity of contract with the defendant, only the coach's owner was in privity with the defendant.[20] The Exchequer said, "unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit, would ensue."[21] Courts in this country interpreted this case as stating a "privity defense" that denied recovery to people, under a contract or a tort theory, with whom the manufacturer did not have a contract.[22] In an admiralty case, *Robin's Dry Dock & Repair Company v. Flint*,[23] Flint, the charterer of a vessel, sued Robin's Dry Dock to recover for loss of use of the vessel due to delays caused by Robin's Dry Dock Company's negligence. The contract for dry-docking was entered into between the vessel's owners and Robin's Dry Dock. Justice Holmes extended this "privity defense" further and remarked that "[t]he law does not spread its protection so far" as to make a "tortfeasor liable to another merely because the injured person was under a contract with that other. . . ."[24]

In 1916, Justice Cardozo, writing for the court in *MacPherson v. Buick Motor Company*, reasoned that courts could hold a manufacturer liable under tort law for personal injuries caused by any product that would be dangerous if negligently made, *regardless of a contract*.[25] This case effectively started the

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18. Barrett, *supra* note 8, at 897.

19. Winterbottom v. Wright, 152 Eng. Rep. 402 (Ex. 1842). The Court of the Exchequer heard some British cases.

20. *Id.*

21. *Id.* at 405.

22. See the leading case, Losee v. Clute, 51 N.Y. 494 (1873) (manufacturer not liable for damage that a boiler caused to plaintiff's property—following the privity rule).

23. Robin's Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 48 S. Ct. 134 (1927).

24. *Id.* at 309, 48 S. Ct. at 135. So, under the reasoning of *Robin's Dry Dock* and using the facts of *Winterbottom*, the coach driver (who had a contract with the owner) could not recover from the repairer by saying that he (the repairer) injured the coach owner, and therefore caused damages to the driver.

25. MacPherson v. Buick Motor Co., 111 N.E. 1050 (N.Y. 1916) (emphasis added).

dismantling of the privity defense and allowed recovery for personal injury due to defective products even without privity of contract. Subsequent decisions further broadened *MacPherson's* holding to include recovery from manufacturers for damage caused by defective products to property other than the product itself.[26]

These decisions eventually led to the adoption of Section 402A of the Restatement (Second) of Torts.[27] Section 402A stated that when a defective product caused *physical harm to the consumer or his property*, the plaintiff could recover from the seller.[28] "Seller" included a manufacturer and any wholesale or retail dealer or distributor.[29]

At about the same time that he was dismantling the "privity defense" in personal injury cases, Judge Cardozo was also articulating the modern version of the economic loss rule that general tort law does not recognize a duty to avoid negligent infliction of economic loss.[30] The law places upon the defendant a tremendous and limitless liability that is out of proportion to his fault if it recognizes such a duty.[31] This is the primary policy behind the economic loss rule today.

Following this modern economic loss rule which recognized that damage to the product itself is purely economic loss, state courts approached recovery of economic loss in products liability law in one of three ways. The majority approach, or pure contract approach, stated that pure economic loss was not recoverable in strict products liability.[32] A minority approach, or the pure tort approach, stated that pure economic loss was recoverable in strict products

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26. *See* Marsh Wood Prods. Co. v. Babcock & Wilcox Co., 240 N.W. 392, 399 (Wis. 1932) (broadened manufacturer's duty of care to include protection against property damage).

27. Restatement (Second) of Torts § 402A (1965).

28. *Id.* Restatement (Second) of Torts § 402A states:

> Special Liability of Seller of Product for Physical Harm to User or Consumer.
>
> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if
>
> (a) the seller is engaged in the business of selling such a product, and
>
> (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.
>
> (2) The rule stated in Subsection (1) applies although
>
> (a) the seller has exercised all possible care in the preparation and sale of his product, and
>
> (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

29. *Id.* at cmt. (f).

30. Ultramares Corp. v. Touche, Niven & Co., 174 N.E. 441 (N.Y. 1931) (holding that an accountant owes no duty to third parties to refrain from negligently causing economic injury).

31. *Id.*

32. Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965) ("[A consumer] can, however, be fairly charged with the risk that the product will not match his economic expectations. . . ." The California Supreme Court would not allow the plaintiff to recover under tort law for damage to the vehicle itself.).

liability.[33] A second minority approach, or the intermediate approach, stated that pure economic loss was recoverable when a defective product created a situation dangerous to persons or other property, and loss occurs from that danger.[34] State courts and the lower federal courts adopted one of these three approaches in general products liability law and admiralty products liability law before the Supreme Court announced its decision in *East River*.

III. THE HULL: *EAST RIVER* AND ITS PROGENY

East River Steamship Corporation v. Transamerica Deleval, Inc. persuaded the majority of jurisdictions to accept the majority approach of the economic loss doctrine, as developed in *Seely*, in products liability cases.[35] In *East River*, the plaintiffs chartered supertankers that malfunctioned while at sea.[36] The plaintiffs sued the manufacturer of the defective turbines for damages under products liability law and under warranty.[37] The trial court found that the shipbuilder had defectively manufactured and designed the turbines, but that the statute of limitations for the warranty action had run.[38] Therefore, the plaintiffs could not recover under a contract theory.[39] The district court granted summary judgment, reasoning that the plaintiff's actions were not recoverable under a tort theory.[40] The Third Circuit, sitting *en banc*, adopted the intermediate approach, as developed in *Northern Power & Engineering Corporation*,[41] but held that the defects were not unreasonably dangerous and therefore affirmed the summary judgment.[42] The Supreme Court granted *certiorari* to resolve the conflict among admiralty courts.[43]

In *East River*, the Supreme Court formally recognized products liability as part of the general maritime law.[44] Furthermore, the Court adopted the majority

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33. Santor v. A & M Karagheusian, Inc., 207 A.2d 305 (N.J. 1965) (The New Jersey Supreme Court held the manufacturer of carpet liable in tort even though the only damage was to the carpet itself).

34. Northern Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324 (Alaska 1981) (The Alaska Supreme Court held that "when a defective product creates a situation potentially dangerous to persons or other property, and loss occurs as a result of that danger, strict liability in tort is an appropriate theory of recovery.").

35. Reeder R. Fox & Patrick J. Loftus, *Riding the Choppy Waters of* East River: *Economic Loss Doctrine Ten Years Later*, 64 Def. Couns. J. 260, 260 (1997).

36. East River S.S. Corp. v. Transamerica Deleval, Inc., 476 U.S. 858, 860-61, 106 S. Ct. 2295, 2296-97 (1986).

37. *Id.* at 861, 106 S. Ct. at 2297.

38. *Id.* at 862, 106 S. Ct. at 2297.

39. *Id.*

40. *Id.*

41. Northern Power & Eng'g Corp. v. Caterpillar Tractor Co., 623 P.2d 324, 324 (Alaska 1981).

42. *East River S.S. Corp.*, 476 U.S. at 862, 106 S. Ct. at 2297.

43. *Id.* at 863, 106 S. Ct. at 2298.

44. *Id.* at 865, 106 S. Ct. at 2299 (holding that a manufacturer in a commercial relationship has no duty under strict products liability to prevent a product from injuring itself).

view, the pure contract approach, that pure economic loss was not recoverable in strict products liability cases.[45] The Court rejected the intermediate approach, as described above and used by the Third Circuit, as "too indeterminate to enable manufacturers easily to structure their business behavior," and the pure tort approach, as described above, "fail[ed] to account for the need to keep products liability and contract law in separate spheres."[46]

Thus, the Supreme Court denied recovery to the plaintiffs, charterers, under products liability because the turbine components, the defective component, caused damage to the turbines and the propulsion system only, the product itself.[47] In adopting the pure contract approach, the Court affirmed the result that damage done to the "product itself" was purely economic loss and was therefore not recoverable under strict products liability law.[48] The Court reasoned that damage to the "product itself" resulted in "the failure of the purchaser to receive the benefit of its bargain."[49] Damage to a "person" or "other property" was not purely economic loss and was therefore recoverable under strict products liability law.

Shortly after *East River*, the American Law Institute proposed the Restatement Third of Torts. Section 21 of that Restatement states that damages are allowed under strict products liability for the loss incurred by harm to "persons" or "other property."[50] The comments to Section 21 recognize the potential difficulty in determining the difference between the "product itself" and "other property" when a component part of a machine or system destroys or causes damage to the rest of the machine or system:

> A product that nondangerously fails to function due to a product defect has clearly caused harm only to itself. A product that fails to function and causes harm to surrounding property has clearly caused harm to other property. However, when a component part of a machine or system destroys the rest of the machine or system, the characterization process becomes more difficult.[51]

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45. *Id.* at 870-71, 106 S. Ct. at 2301-02.

46. *Id.*

47. *Id.* at 875, 106 S. Ct. at 2304.

48. Damage done to the "product itself" does not deny recovery under contract law (warranty). *Id.* at 872, 106 S. Ct. at 2302-03.

49. *Id.* at 870, 106 S. Ct. at 2302.

50. Definition of "Harm to Persons or Property": Recovery for Economic Loss

For purposes of this Restatement, harm to persons or property includes economic loss if caused by harm to:

(a) the plaintiff's person;

(b) the person of another when harm to the other interferes with a legally protected interest of the plaintiff; or

(c) the plaintiff's property other than the defective product itself.

Restatement (Third) of Torts § 21 (Proposed Final Draft 1997).

51. *Id.* at cmt. e.

Since the decision in *East River*, admiralty courts have wrestled with characterizing the item damaged as either the "product itself" or "other property" when there is a products liability action between the original purchaser and the manufacturer. In *Shipco 2295 v. Avondale Shipyards, Inc.*, the Fifth Circuit held that the vessel was the "product itself."[52] Therefore, damage to the vessel caused by certain defective components in the same vessel was not recoverable under products liability law.[53] The court said that the object of the contract between the purchaser and the manufacturer is considered the "product itself" and not each individual component of the vessel.[54] The court used the same reasoning that the Supreme Court used in *East River*: "Since all but the very simplest of machines have component parts, [a contrary] holding would require a finding of 'property damage' in virtually every case where a product damages itself. Such a holding would eliminate the distinction between warranty and strict products liability."[55]

In *Nicor Supply Ships Associates v. General Motors Corporation*,[56] a bareboat charterer installed electronic seismic equipment on the deck of the vessel. Judge Rubin, writing for the Fifth Circuit, reasoned that equipment placed on board the vessel by the charterer was "other property."[57] Therefore, when a defective component damages equipment added to the initial product, the damage to that equipment was recoverable under products liability law.[58] The court reasoned, "[b]ecause these items were *not part of the contract under which the vessel was sold,* damage to them is an injury for which their proprietor may recover in tort."[59]

The natural extension of the holdings of these cases was inevitable. The question would arise as to how the "product itself" is defined when a subsequent purchaser buys the "product" with the "added components" already installed. Recovery would depend on the moment in time that the "product itself" is defined. Purchasers and their insurers want to define the "product itself" as a static, fixed item, so that they can recover their losses under products liability. Manufacturers and their insurers would prefer that the "product itself" be a fluid, changing item, so that they are not be liable for the second purchaser's losses under products liability law.

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52. Shipco 2295, Inc. v. Avondale Shipyards, Inc., 825 F.2d 925, 929 (5th Cir. 1987).

53. *Id.* at 930 ("[T]he product in this context means the finished product bargained for by the buyer rather than components furnished by a supplier.").

54. *Id.* at 928.

55. *Id.*

56. Nicor Supply Ships Assocs. v. General Motors Corp., 876 F.2d 501, 502 (5th Cir. 1989).

57. *Id.* at 506.

58. *Id.*

59. *Id.* at 506 (emphasis added).

IV. THE CAPTAIN'S MAST: *SARATOGA FISHING CO. V. J.M. MARTINAC & CO.*

A. The Case

In 1971, J.M. Martinac & Company ("Martinac"), a shipbuilder, contracted with Joseph Madruga ("Madruga") to design and build the M/V SARATOGA ("SARATOGA").[60] Martinac, after consultation with Madruga, contracted with Marco Seattle, Inc. ("Marco") to design the hydraulic system.[61] Martinac installed the hydraulic system, and Marco inspected it after it was installed.[62] The SARATOGA was launched in 1972.[63]

After the SARATOGA was in Madruga's possession, he outfitted her with extra equipment needed for tuna fishing, including five speedboats, a purse skiff, a seine net, and various spare parts.[64] In 1974, Madruga sold the SARATOGA to Saratoga Fishing Co. ("Saratoga Fishing").[65]

In 1986, between Panama and the Galapagos Islands, the hot surface of the SARATOGA's turbocharger ignited leaking hydraulic fluid, causing a fire in the engine room.[66] The crew attempted to extinguish the fire, but it quickly spread.[67] The crew abandoned ship and the SARATOGA sank.[68]

Saratoga Fishing brought suit against Martinac and Marco in admiralty to recover property losses.[69] The trial court found that Martinac and Marco defectively designed the hydraulic system.[70] It held Martinac and Marco strictly liable for the loss of the SARATOGA.[71] The damages included the loss of the equipment that Madruga added to the SARATOGA after its purchase from Martinac.[72] The award consisted of the combined values of the tuna catch, seine net, purse skiff, fuel, assorted equipment, crew losses, rescue costs, and

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60. Saratoga Fishing Co. v. Marco Seattle, Inc., 69 F.3d 1432, 1435 (9th Cir. 1995). Neither the Ninth Circuit nor the Supreme Court explained Madruga's business. He owned the SARATOGA for about two years. Justice Scalia, in his dissent, comments that this is an important fact the majority ignores. To Justice Scalia, it appears that Madruga is in the business of designing, assembling and distributing ships (this was the third of seven ships Madruga commissioned). *See* Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1790 (1997).

61. *Saratoga Fishing Co.*, 69 F.3d at 1435.

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.* at 1435. The captain of the SARATOGA formed this company while operating the vessel for Madruga. *Id.*

66. *Id.* at 1436.

67. *Id.*

68. *Id.*

69. *Id.*

70. Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1785 (1997).

71. *Id.*

72. *Id.* Saratoga Fishing's comparative fault reduced the award by two-thirds. The award amounted to $734,940.38 after prejudgment interest. *Saratoga Fishing Co.*, 69 F.3d at 1437.

cash.[73] The court did not make an award for replacement parts and the vessel's hull.[74]

Both sides appealed the district court's ruling.[75] Martinac, Marco and Saratoga Fishing appealed for several reasons not pertinent to the Supreme Court's decision.[76] All three parties made various objections to the award for damages.[77] The Ninth Circuit held that since the object of the contract between Saratoga Fishing and Madruga was the SARATOGA; the net, skiff, fuel, spare parts, and miscellaneous parts that Madruga installed were part of the "product itself."[78] Therefore, these items were not recoverable in a tort action as "other property."[79] The Ninth Circuit Court of Appeals applied the economic loss doctrine that the Supreme Court adopted in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, distinguishing between damage to the "product itself" and damage to "other property."[80] Therefore, "[w]hen the product itself is damaged, the 'resulting loss is purely economic' and losses such as 'repair costs, decreased value, and lost profits . . . essentially [involve] the failure of the purchaser to receive the benefit of its bargain—traditionally the core concern of contract law.'"[81] The Ninth Circuit continued:

> We are guided by the policies set forth in *East River*, where the Court stated that *the focus of the product should be on the failure of the purchaser to receive the benefit of its bargain*. . . . Here, the purchaser is Saratoga Fishing and the object of its bargain was the M/V SARATOGA with the components already installed. . . . Madruga made no "warranty or representation of vessel condition."[82]

Judge Noonan's opinion, concurring and dissenting, argued that the equipment Madruga added was "other property."[83] He reasoned that the "product itself" was the ship Martinac sold to Madruga.[84]

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73. *Saratoga Fishing Co.*, 69 F.3d at 1444.

74. *Id.*

75. *Id.* at 1435.

76. Martinac and Marco contended that the district court erred in three ways: concluding that they owed a duty to Saratoga Fishing, concluding that the design of the hydraulic system was defective, and concluding that Saratoga Fishing's alterations of the hydraulic system were not a superseding cause of the fire. Saratoga Fishing contends that the court erred by reducing its recovery by two-thirds on account of comparative fault. The Ninth Circuit agreed with the district court on all of these issues. *Id.* at 1438, 1439, 1442, 1443.

77. *Id.* at 1444.

78. *Id.* at 1445.

79. *Id.* at 1445. The Ninth Circuit held that the tuna catch was "other property," and therefore recoverable in tort. The replacement equipment and the vessel's hull was categorized as the "product itself" and therefore not recoverable in tort. *Id.* at 1445.

80. *Id.* at 1444; *East River S.S. Corp.*, 476 U.S. 858, 106 S. Ct. 2295.

81. *Id.* at 1444 (citing *East River S.S. Corp.*, 476 U.S. at 870, 106 S. Ct. at 2301-02).

82. *Id.* at 1444 (emphasis added).

83. *Id.* at 1447.

84. *Id.*

The Supreme Court granted *certiorari* to "resolve this uncertainty about the proper application of *East River*."[85] The issue was how was the initial user's added equipment categorized when the initial user sold the manufactured item and the added equipment to a subsequent user. The Supreme Court held that under *East River* the initial purchaser-added equipment constituted "other property" and therefore defined the "product itself" as the item the initial user bought.[86]

Justice Breyer's majority opinion stated the disposition of the case as follows:

> (1) a Component Supplier who (2) provided a defective component (the hydraulic system) to a Manufacturer, who incorporated it into a manufactured product (the ship), which (3) the Manufacturer sold to an Initial User, who (4) after adding equipment and using the ship, resold it to a Subsequent User (Saratoga Fishing).[87]

Arguably, Madruga was a manufacturer and the vessel that he bought was just a component part of a tuna-fishing vessel.[88] Under the majority's holding, the question of whether Madruga was a manufacturer is irrelevant, as long as he "used" the item that he bought.[89]

The majority criticized the Ninth Circuit's holding as creating tort damage immunity beyond that set out by any relevant precedent.[90] The Court said that many states allow a purchaser to recover the value of an item that the purchaser adds to or uses in connection with a defective item.[91] It then reasoned that since the initial user could have recovered for added items, the subsequent user should be able to recover.[92] The Court added that it was unable to find any case that held that the manufacturer was not liable in tort when the purchaser sells an item to a subsequent user.[93]

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85. Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1786 (1997).

86. *Id.* at 1785.

87. *Id.* at 1786. The majority consisted of the opinion of Breyer, J. with Rehnquist, C.J. and Stevens, Kennedy, Souter, and Ginsburg, JJ. joining. The dissent consisted of the opinion of Scalia, J. with Thomas, J. joining and O'Connor, J. joining, except that she thought the Court should have granted certiorari (Justices Scalia and Thomas voted against granting certiorari in this case). *Id.* at 1785.

88. This causes some concern for the dissent. *See infra* text accompanying notes 108-111.

89. Now, the inevitable question is, "what is an initial user?" What if a manufacturer "test runs" an engine before he delivers the engine to the manufacturer of the ship?

90. *Saratoga Fishing Co.*, 117 S. Ct. at 1787.

91. *Id.* (citing A.J. Decoster Co. v. Westinghouse Elec. Corp., 634 A.2d 1330 (Md. 1994) (A chicken farm owner recovered when chickens were killed by a defective ventilation system)); United Air Lines, Inc. v. CEI Indus. of Ill., Inc., 499 N.E.2d 558 (Ill. 1986) (A warehouse owner recovered for damage to the warehouse caused by a defective roof).

92. *Saratoga Fishing Co.*, 117 S. Ct. at 1787. To the author this looks like a type of subrogation theory.

93. *Id.* at 1787. It should be added here that the Court does not cite any case that holds a manufacturer liable in tort for added components when the purchaser sells the item to a subsequent user.

The Court said that to deny recovery to the subsequent user would make the manufacturer's liability depend upon a fortuity—whether the defective component caused damage to the added equipment before or after the user that added the equipment sold it to the subsequent user.[94] It stated that to apply this rule would diminish the main policy behind product tort law—to encourage manufacturers to manufacture safer products.[95]

The majority recognized that under *East River* parties could contract for sharing of the risks of harm.[96] Nevertheless, this sharing of the risk did not work in the context of resale of the defective item because subsequent users did not contract directly with the manufacturer.[97] The primary reason being that the initial purchaser was not in a position similar to that of a manufacturer to offer a warranty because the purchaser knows less about the risks of giving a warranty on the defective product.[98]

The Court rejected two of the defendant's other arguments. The first argument was that the Court's reasoning proved that an initial user may recover for damage a defective component part caused to the manufactured product, other than the defective component part itself.[99] But, the Court agreed with several lower court decisions[100] holding that it is the manufactured vessel and not the component that is the "product itself."[101] The reason was that manufacturers and component suppliers are able to divide the risks of a product through contract.[102] The contractual risks give the component supplier enough incentive to prevent manufacturing defective components.[103] The Court stated "[t]here is no reason to think that initial users systematically control the manufactured product's quality or, as we have said, systematically allocate responsibility for user-added equipment, in similar ways."[104] The defendant's second argument was that the Court's "holding would impose too great a potential tort liability upon a manufacturer or distributor."[105] The Court rejected this argument saying that other tort principles, such as foreseeability and proximate cause, would limit the liability of the manufacturer or distributor.[106] Furthermore, if

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94. *Id.* Justice Scalia replies that the majority is just substituting one fortuity for another. *See infra* text accompanying notes 114-115.

95. *Saratoga Fishing Co.*, 117 S. Ct. at 1787.

96. *Id.*

97. *Id.*

98. *Id.* at 1788.

99. *Id.*

100. *Id.* For example, *see* Shipco 2295, Inc. v. Avondale Shipyards, Inc., 825 F.2d 925 (5th Cir. 1987); Nicor Supply Ships Assoc. v. General Motors Corp., 876 F.2d 501 (5th Cir. 1989).

101. *See Shipco 2295, Inc.*, 825 F.2d 925; National Union Fire Ins. Co. of Pittsburgh v. Pratt & Whitney Canada, Inc., 815 P.2d 601, 604 (Nev. 1991).

102. *Saratoga Fishing Co.*, 117 S. Ct. at 1788.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

the initial user continued to own the manufactured product, he could recover damages to the added equipment.[107]

B. The Dissent

In Justice Scalia's dissent, he argued that the fact pattern, as laid out by the majority, was misleading.[108] The majority did not mention that Madruga appeared to be more than just a user of the boat.[109] Madruga participated in her design and construction in the shipyard.[110] Arguably, Madruga received from Martinac a component of a tuna fishing boat, and Madruga was itself a manufacturer or distributor.[111] Because not mentioned by the majority decision, the dissent assumed that the majority considered Madruga's involvement irrelevant.[112] Therefore, the majority held the "product" fixed when sold to an initial user even if that user was engaged in the business of reselling the product.[113]

Responding to the majority's statement that denying recovery to a subsequent user makes the manufacturer's liability depend upon a fortuity,[114] Justice Scalia replied that the majority's decision made liability turn on a different fortuity—whether the purchaser who added equipment to the product used it or not before selling it.[115] One way to avoid either of these fortuities would be to apply the "last-402A-seller rule."[116] "Under this rule, the 'product' would be fixed when it was sold by the last person in the chain of distribution who is, in the words of § 402A of the Restatement (Second) of Torts (1964), 'engaged in the business of selling such a product.'"[117] The dissent recognized that in most cases this rule produces the same result as the majority's rule.[118] However, the same result will not occur in all cases.[119]

Therefore, both the "initial user" rule and the "last 402A seller" rule depend upon when the product was put into the stream of commerce.[120] The dissent stated that the rule should depend on the item that the plaintiff bargained for in

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107. *Id.*

108. He began his dissent by stating that he did not believe that the Supreme Court should have granted certiorari in this case. A lower court has not decided this precise issue and it would have been better to let the lower federal courts and state courts develop these new common law rules of tort and contract law in commercial transactions. *Id.* at 1789.

109. *Id.* at 1790.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *See supra* text accompanying note 94.

115. *Saratoga Fishing Co.*, 117 S. Ct. at 1790.

116. *Id.*

117. *Id. See also supra* note 28.

118. *Id.*

119. *Id.* This point will be explained more thoroughly in Section V.

120. *Id.* at 1791.

his contract with the defendant.[121] In a transaction with commercial entities, such as this transaction, the contracting parties do not usually have a great disparity in bargaining power.[122] Furthermore, the purchaser can insure the products that he has bought.[123] Therefore, according to the dissent, contract law, recovery under warranty, should apply, and the Court should not import tort law into this situation.[124] To support its theory, the dissent cited a long list of federal and state court decisions which denied the purchaser of defective equipment from recovering in tort for the damage on the theory of "other property," and that the reasoning in these decisions depended upon the "object-of-the-bargain" rule.[125] Justice Scalia states the "object-of-the-bargain" rule was in accord with the policy judgments made by the Supreme Court in *East River*.[126]

V. THE VIEW FROM THE BRIDGE: EVALUATION

A. "Initial User" Rule, "Last 402A Seller" Rule, or "Object-of-the-Bargain" Rule?

The "initial user" rule, as developed by the majority decision in *Saratoga Fishing*, defines the product itself as the item that the first user has purchased.[127] The "last 402A seller" rule defines the product itself as the item that is sold by the last seller as defined in the Restatement (Second) of Torts section 402.[128] In Section 402A a seller is one who "is engaged in the business of selling such a product."[129] The "object-of-the-bargain" rule defines the product itself as the item for which the plaintiff bargained and received.[130]

As Justice Scalia pointed out in his dissent, in most cases the first two rules will provide the same result.[131] This following hypothetical clarifies the distinction between the rules. Captain, a retail dealer, was engaged in the business of selling boats. He purchased two boats from Shipyard, the manufacturer of the boats, installing an echo depth-sounding device on each of the boats after purchase. He used one of the boats as a demonstration model and leased the boat out to potential customers. Both of the boats are thereafter sold to two commercial entities, Able bought the demonstration model and Bodied bought

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121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* The "object-of-the-bargain" rule looks to the product purchased by the plaintiff in determining "other property." *Id.*
126. *Id.*
127. *Id.* at 1786.
128. *Id.* at 1790. *See supra* note 28.
129. Restatement (Second) of Torts § 402A(1)(a) (1965).
130. *Saratoga Fishing Co.*, 117 S. Ct. at 1791.
131. *Id.* at 1790.

the other boat. Each boat developed a leak that is attributed to Shipyard (a defective weld).

Under the "initial user" rule adopted by the majority, Able's device would be "other property." Captain would be the initial user and the "product itself" would be the boat. Damages for the loss of his device would be recoverable under strict products liability from Shipyard. However, Bodied's device would be categorized as part of the "product itself." Because Captain never used Bodied's boat, the initial user would be Bodied and the "product itself" would be the boat with the device installed. Damages for the loss of the device would not be recoverable under strict products liability law from Shipyard. Under the "last 402A seller" rule, the devices on both of the boats would be part of the "product itself." The "last 402A seller" is Captain and the product sold was the boat with the device installed.

Under the "object-of-the-bargain" rule, we look to what the plaintiffs purchase and therefore both devices are part of the product itself and therefore, neither Able nor Bodied can recover for damages for the loss of the devices. The difference between this rule, the "initial user" rule, and the "last 402A seller" rule is illustrated by a change in the hypothetical. Suppose Able added a radio to his boat and then sold the boat to Seaman. Under the "initial user" and "last 402A seller" rules the analysis is the same—the court looks to what the initial user purchased and what the last 402A seller sold respectively; the product is fixed. The radio was recoverable in each of these situations since it was not part of the initial user's boat and not part of the boat when the last 402A seller sold the boat. Under the "object-of-the-bargain" rule, the court looks for the item that Seaman bargained for to define the product. Seaman bargained for the boat with the device and the radio. This rule defines the boat with the device and the radio as the "product itself" and Seaman would not be able to recover tort damages from the loss of the device or the loss of the radio. Practically, the "initial user" rule defines the "product itself" as fixed the first time someone uses it. The "last 402A seller" rule defines the product as fixed when the last 402A seller sold it. The "object-of-the-bargain" rule changes the "product itself" with every subsequent purchase.

The Court's only explanation as to why the "initial user" rule is better than the other rules is that the "initial user" rule maintains the manufacturer's liability for equipment added after the initial sale.[132] The "last 402A seller" rule does this also, and is more consistent in its application than the "initial user" rule. The reason being that the "last 402A seller" is already defined for the courts in the Restatement (Second) of Torts and jurisprudence.[133] The courts have not defined the "initial user" and this could lead to some problems for certain

132. *Id.* at 1788. Arguably, the Court may just be looking for a "bright line" test to easily separate the "product itself" from "other property." One can only hope that this is not driving the majority's opinion.

133. *See supra* text accompanying note 26.

components of a product. There is no reason for allowing Able the ability to recover in tort for the device without allowing Bodied the ability, which the "initial user" rule commands.

Moreover, the "object-of-the-bargain" rule logically is the better rule when the product involved is a part of a transaction that involves commercial entities. In these type of transactions, the parties usually negotiate at "arm's length" and there is usually little disparity in bargaining power. Although the initial seller (manufacturer) takes advantage of the second contract, of which he is not a party, all parties involved are much better able to protect themselves through contracts and insurance. The manufacturer can still offer a warranty and raise his price to compensate any losses occurring under this warranty. The first purchaser has the option of foregoing the warranty and insuring the risk of loss himself. Accordingly, the decision will be made between these two depending upon which party wants to bear the risk of loss. Applying this rule to transactions involving commercial entities would allow the court to maintain the separation between the "spheres of contract law and tort law" that was so important in *East River*.[134] The manufacturer should be protected because the item has left his possession. He is usually unsure of the value of the items added to the product. However, the purchaser can easily buy insurance for the product. He is in a better position to know the value of the component parts added to the product. Furthermore, the vessel is in his possession, which enables the insurer to inspect the vessel at periodic intervals to notice dangerous situations. The majority's solution in *Saratoga Fishing Co.*, for protecting the manufacturer is that other tort principles, such as foreseeability, can limit the liability of the manufacturer.[135] Recovery for equipment, or components that are added to the manufactured product by the initial user is limited to equipment that the manufacturer can reasonably foresee as being added to the product. The problem with this solution is that the courts make the foreseeability determination after the transaction, and manufacturers would like to limit their liability at the time of the transaction.

B. What About the Policies Involved?

The primary policy behind strict products liability is to encourage the manufacture of safer products. The *Saratoga Fishing Co.* majority argued that the "object-of-the-bargain" rule diminishes this policy.[136] The rule limits the manufacturer's liability for equipment that the initial purchaser added to the manufactured product once the initial purchaser sells the item to a subsequent purchaser.[137] On the other hand, there are two reasons that not limiting the

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134. As pointed out in Section VI of this paper, some jurisdictions already separate commercial transactions from noncommercial transactions, and allow recovery for damage to the property itself in noncommercial transactions. *See infra* note 152.

135. *Saratoga Fishing Co.*, 117 S. Ct. at 1788.

136. *Id.* at 1787.

137. *Id.* at 1788.

manufacturer's liability may have an overdeterrent effect on useful behavior. First, the manufacturer's contractual freedom is limited. Take for example a common transaction involving commercial entities. Assume that in the previous hypothetical Shipyard contracted with Able to limit his liability for damage to the equipment added by Able.[138] Under the majority's holding, when Seaman purchased the boat from Able, the manufacturer loses his contractually limited liability as to the equipment added by Able. Practically, Shipyard has no ability to limit his liability to subsequent purchasers. In effect, the "initial user" rule gives the manufacturer less incentive to contractually limit his liability with initial purchasers.[139] Second, the shift from recovery in contract to one of strict products liability tells manufacturers that greater care is not a defense.[140] In reality, strict liability gives the manufacturer less incentive to take greater care because he will still be liable even if he "exercise[s] all possible care in the preparation and sale of his product."[141] Manufacturers realize that strict liability is a part of doing business and raise prices to spread the cost among its purchasers.

Another policy behind strict products liability is that manufacturers and sellers are held liable because society considers them better able to bear the costs of injuries and damages resulting from defective products.[142] This policy withstands scrutiny for the typical consumer transaction because we have a public policy of protecting the powerless consumer, but is not very convincing when courts apply it to a situation such as the one in *Saratoga Fishing Co.* The sale in *Saratoga Fishing Co.* arose from a transaction involving commercial entities, not a consumer transaction. All of the parties were commercial actors dealing at "arm's length" with less disparity in bargaining power than in a typical consumer transaction so there is not as much as a reason to protect the commercial entity as there is to protect consumers.

The main reason that Saratoga did not buy the vessel from Martinac was probably an economic reason. If Saratoga had bought the vessel from Martinac, Saratoga would have paid a "premium" price and probably would have received a warranty with the vessel. Instead, Saratoga decided to purchase the vessel from Madruga for a much lower price and "as is," with no warranty.[143] In this

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138. *See Saratoga Fishing Co.*, 117 S. Ct. at 1787 ("[Nothing] prevent[s] a Manufacturer and an Initial User from apportioning through their contract potential loss of any other items—say, added equipment or totally separate physical property—that a defective manufactured product . . . might cause.").

139. The most common incentive for initial purchasers to enter into a contract limiting the manufacturer's liability is that the initial purchaser is charged a lower sales price. Therefore, the "initial user" rule hurts the initial purchaser by not allowing him as big of a discount in buying an item that he would be able to get if the manufacturer could limit his liability.

140. Matthew Bender & Co., Products Liability § 13.14[10] (1995).

141. Restatement (Second) of Torts § 402A(2)(a) (1965).

142. W. Page Keeton et al., Prosser and Keeton on the Law of Torts § 98, at 692-93 (5th ed. 1984).

143. Saratoga Fishing Co. v. Marco Seattle Inc., 69 F.3d 1432, 1435 (9th Cir. 1995).

context, it makes more sense to hold the subsequent purchaser to contractual remedies. He received value in a lower price by foregoing the warranty by the manufacturer.[144] The subsequent purchaser should not be able to collect in tort for a product that he bargained for without a warranty. The contractual remedies should apply to the whole product, including added components that he bargained for. The buyer did not negotiate a warranty in his bargain with the initial purchaser. The majority in *Saratoga Fishing Co.* states that "it is more difficult for a consumer—a commercial user and reseller—to offer an appropriate warranty on the used product he sells akin to a manufacturer's warranty of the initial product."[145] Of course it is more difficult for the initial purchaser to offer a warranty, but this should not stop the courts from holding the parties to their contractual remedies. Accordingly, we have to assume that it is more expensive for the initial purchaser to buy insurance to offer a warranty. Therefore, many initial purchasers will not offer a warranty and sell the product "as is." This is one of the reasons that the subsequent purchaser purchases a product from the initial purchaser—he can buy it at a cheaper price by foregoing a warranty. If he wanted a warranty, he would purchase the product at a higher price from the manufacturer or the initial purchaser.

In addition, if the reasoning that "manufacturers are better able to bear the risks" applies then this reasoning must apply anytime a superior risk bearer injures someone.[146] The reasoning behind this policy is that manufacturers have the capacity to distribute the damages of a few people among the many people who purchase the products.[147] Again, this policy is very convincing when applied to a typical consumer transaction where a large company is selling to many individuals. But when commercial entities sell to commercial entities, the purchaser is usually in a better position to accept the risk. He can usually obtain insurance more easily and usually cheaper. This argument, of "manufacturers being in a better position to accept the risks," if brought to its logical extreme would call for a governmental compensation scheme for all injuries.[148]

VI. THE WAKE: OBSERVATIONS AND PREDICTIONS

The majority suggests that the question of whether the equipment constitutes "other property" is a legal question of determining the item that the initial user

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144. Arguably, Saratoga did the same thing that it would have done if it purchased the vessel from Martinac. He could have purchased a vessel from Martinac "as is," waive all warranties, and receive a lower price.

145. Saratoga Fishing Co. v. J.M. Martinac & Co., 117 S. Ct. 1783, 1787 (1997).

146. David G. Owen, *Rethinking the Policies of Strict Products Liability*, 33 Vand. L. Rev. 681, 707 (1980).

147. Keeton et. al., *supra* note 142, § 98, at 692-93.

148. Owen, *supra* note 146, at 705-06. The government can spread the cost of any injury by taxing people. Basically, in products liability, the manufacturers are taxing purchasers to pay for injuries caused by their products. In transactions involving commercial entities, it is usually more efficient for the purchaser to insure his product.

bought from the manufacturer. The question looks to the nature of the contract to determine which person is the "initial user." Justice Scalia mentions that in this case Madruga may be a manufacturer itself.[149] This suggests that the court could ultimately treat this question as a factual question. If state courts adopt Justice Scalia's reasoning into the general tort law, the jury will decide the question of who is the initial user by looking at the facts and circumstances of the case. But if the question is a legal one to be decided by the judge then there needs to be a standard definition of the term "initial user," which the court does not provide in *Saratoga Fishing Co.*

As a result of this decision, manufacturers of products are likely to incorporate complicated indemnity agreements in their contracts of sale when limiting warranty actions. These indemnity agreements will state that the purchaser will indemnify the manufacturer for any liability for equipment added to the original product. The initial purchaser will then require the same indemnity from his purchaser and this will continue down the line. Therefore, this decision creates a situation where the parties will create a vicious "indemnity circle." The subsequent purchaser will bring suit against the manufacturer. The manufacturer will then bring suit against the initial user. The initial user will then bring suit against the subsequent purchaser. So, it is pointless for the subsequent purchaser to bring suit unless the "indemnity circle" was broken by not including the indemnity provision within one of the contracts of sale.

The majority of jurisdictions that have considered the question of recovery when a product causes damage to itself have adopted the reasoning of *East River* and now deem that sort of damage to be economic loss that is not recoverable in tort.[150] Therefore, *East River*'s approach to the economic loss doctrine has affected products liability law in state causes of action, as well as in admiralty.[151]

Saratoga Fishing's impact upon products liability law outside of admiralty may have the same broad effect as *East River*. In actuality, *Saratoga Fishing* began where *East River* left off. *East River* offered little guidance on how a court distinguishes between damage to "other property" and damage to the "product itself." As a result, every jurisdiction that has adopted the economic loss doctrine[152] may follow the Supreme Court's lead on this question. As early as four months after the *Saratoga Fishing* decision the holding, defining the "product itself" as the item that the initial user purchases from the manufacturer, was used by a federal appellate court that assumed that the Pennsylvania

149. *Saratoga Fishing Co.*, 117 S. Ct. at 1789.

150. Christopher S. D'Angelo, *The Economic Loss Doctrine: Saving Contract Warranty Law from Drowning in a Sea of Torts*, 26 U. Tol. L. Rev. 591, 595 (1995).

151. *Id.*

152. All states have adopted some form of the economic loss doctrine, except that Colorado, Michigan, and New Jersey have not adopted the economic loss doctrine in non-commercial transactions (consumer transactions). *Id.* at 608-19.

Supreme Court would accept it as part of Pennsylvania products liability law.[153]

Admittedly, state courts and even legislatures will be persuaded and encouraged by the decision in *Saratoga Fishing Co.* to adopt the "initial user" rule to define the "product itself." Nevertheless, these groups should look to whether they want to keep the spheres of contract law and tort law separate and the policies involved before adopting this rule into the states' products liability laws.

Chadwick J. Mollere

153. 2-J Corp. v. William E. Tice, III, 126 F.3d 539 (3d Cir. 1997) (holding that inventory stored in a warehouse is "other property" as defined by the holding in *Saratoga Fishing*, which the court was confident that the Supreme Court of Pennsylvania would accept. But this case was not a case where a subsequent purchaser bought the warehouse. Accordingly, in this case all three rules would have produced the same result.).